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No. 536

In the

Supreme Court of the United States

OCTOBER TERM, 1968

JOSEPH REITER and
LEROY GUNTNER, Co-trustees,

Petitioners,

vs.

FEDERAL SAVINGS AND LOAN
INSURANCE CORPORATION,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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The Scheffer Press, Inc.—ANdover 3-6850

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Petitioners herein, co-trustees, Joseph Reiter and Leroy Guntner, pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Seventh Circuit rendered on June 7, 1968.

OPINIONS BELOW

The opinion and judgment of the United States District Court for the Northern District of Illinois awarding the funds in controversy to petitioners is unreported and is set forth in *Appendix,* p. 1a.

The opinion of the United States Court of Appeals for the Seventh Circuit, reversing the trial court without remand, is set forth in *Appendix,* p. 9a, and is reported at 396 F. 2d 407.

JURISDICTION

The jurisdiction of this Court is invoked under 28 U.S.C. §1254 (1). The judgment of the United States Court of Appeals for the Seventh Circuit was entered on June 7, 1968. The timely filed petition for rehearing was denied on July 2, 1968.

QUESTIONS PRESENTED

1. Whether the Federal Home Loan Bank Board exceeded its authority in compelling depositors of a Federal Savings and Loan Association to sign an Agreement using their deposits as a guarantee against future losses as a condition for issuance of a federal charter.
2. Whether the Federal Savings and Loan Insurance Corporation may withhold insurance benefits from depositors who have not waived their rights under the National Housing Act.

STATUTES INVOLVED

The statutory provisions involved in this case are 12 U.S.C.A. 1728 (b) and 12 U.S.C.A. 1464(a). They are set forth in full in *Appendix,* p. 19a. Also involved is 12 C.F.R. Ch. V(c), §543.2, Rules and Regulations of the Federal Savings and Loan System (set forth also in *Appendix,* p. 20a.

STATEMENT OF THE CASE

Joseph Reiter and LeRoy Guntner, co-trustees, plaintiffs and appellees, filed a complaint for a declaratory judgment against Federal Savings and Loan Insurance Corporation, a corporate instrumentality of the United States. Plaintiffs asked the District Court to adjudicate the rights of the parties in an account or deposit originally of $55,557.26 at Merchandise National Bank of Chicago and now of $50,000.00 at National Boulevard Bank of Chicago.[1] (App. 4, 94)

The District Court sustained a motion for summary judgment filed by plaintiffs and overruled a similar motion by defendant. It declared plaintiffs to be the owners of the account or deposit in controversy and defendant to be without any interest therein. (App. 90) This appeal followed.

This case presents only questions of law raised on the uncontroverted following facts. First Federal Savings and Loan Association of Morton Grove (First Federal) was chartered on August 1, 1959, by the Federal Home Loan Bank Board (the Board). (App. 12). The Board is the agency of the United States charged with the responsibility of chartering and regulating federal savings and loan associations. The Board prescribed as a condition for the issuance of that charter the "pledge" of savings

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[1] Throughout the record before the Court there are references to these two figures. The $50,000.00 represents the original amount of certain savings share accounts pledged by plaintiffs and the $55,557.26 represents the same accounts augmented by dividends or interest which were credited thereto. A discussion of the case sometimes requires a reference to the $55,557.26 figure, but the parties have agreed that only the $50,000.00 is in controversy.

share accounts of First Federal in the amount of $50,000.00 as a guaranty by the pledgors to First Federal against future losses. (App. 62) The Federal Savings and Loan Insurance Corporation has the same management as the Board but is a separate corporation.

The terms of the pledge were incorporated in the "Pledge and Escrow Agreement". (App. 62) This Agreement was to remain in effect for five years beginning on August 1, 1959, the date of the issuance of the charter to First Federal. (App. 64) The Agreement provided that whenever the Board found an impairment in the capital of First Federal or any deficit in any accounting period, the Board might direct the Federal Home Loan Bank of Chicago to deliver the pledged share accounts to First Federal for cancellation and for transfer of the dollar amounts thereof to First Federal's reserves for the purpose of absorbing losses. (App. 64) It further provided that if any charges against the pledged share accounts had been made, a refund thereof should be forthcoming, after the termination of the Agreement on August 1, 1964, provided such refund would not reduce the net reserves of First Federal to less than three per cent of its net assets. (App. 64) It provided that the pledged share accounts might be delivered for similar cancellation and transfer on liquidation of First Federal. (App. 64). The exact language of the Pledge and Escrow Agreement is as follows: (App. 63)

> "Now, Therefore, • • • the undersigned do hereby assign and deliver as of the date hereinabove first written the shares of said First Federal Savings and Loan Association of Morton Grove, as hereinafter described in the amounts stated as shown opposite their respective names in the total amount of $50,000, in escrow to the Federal Home Loan Bank of Chicago,

to be held by it as a pledge and guaranty to First Federal Savings and Loan Association of Morton Grove against operating deficits and losses of any and all kinds which exceed other reserves; this pledge and agreement to remain in full force and effect for a period of five years beginning August 1, 1959; provided that after the expiration of the first three years of the term of this agreement, the release of said pledge and escrow, in whole or in part, may be authorized by the Federal Home Loan Bank Board whenever the net reserves established for the purpose of absorbing losses and surplus of the association together equal at least 3% of its net assets.

"It is agreed that, whenever the Federal Home Loan Bank Board finds that any impairment in the capital of the association or any deficit in any accounting period exists after the payment of all expenses incurred, provision for dividends and proper allocations to reserves and surplus, the said Board is authorized from time to time in its discretion, to direct the Federal Home Loan Bank of Chicago to deliver the shares herein pledged or any portion thereof, pro rata to the amount to the credit of the undersigned, to said association for cancellation and simultaneous transfer upon its books of the dollar amount of credits represented by such cancelled shares to the reserves of said association for the purpose of absorbing such losses or operating deficits. Such shares may likewise be delivered for cancellation in the manner and for the purposes hereinabove provided, in the event of the liquidation of the said association.

"If during the life of this agreement there shall have been any charges against the share accounts herein pledged, the said association shall, whenever possible after the termination of this agreement, refund such amounts on a pro rata basis to the pledgors; provided, however, that no refund to any pledgor shall exceed the amount such pledgor has

been required to forfeit by reason of the terms of this agreement; and provided, further, that no such refund shall be made when the said association's net reserves for losses and surplus would thereby be reduced to less than 3% of its net assets.

"The aforesaid Board may from time to time release all or part of the shares of any of the pledgors, provided that shares of the association, in an amount at least equal to the shares released, shall be substituted by a pledgor or pledgors who shall agree to be bound by the terms of this agreement, without any further consent or agreement of other pledgors, the undersigned or any of them."

The document called "Pledge and Escrow agreement" was signed by 17 depositors. Although the Federal Home Loan Bank Board was a party it did not sign the document (App. 65). Only 7 depositors were later directors or officers of First Federal (App. 69, 70). The record is clear that approximately ten depositors were in no way connected with the promotion, organization, or management of First Federal (App. 65, 69, 70). The funds were kept in twelve different accounts (App. 65-67). Two of the original depositors were allowed to withdraw their funds and substitute deposits were made to bring the total to $50,000.00 (App. 66, 67).

Until the early part of 1964, the manager of First Federal was Richard Brooker who is not a party here. (App. 68). The question of losses was not in issue in the trial court, nor should it be an issue on appeal. It can be assumed, for the sake of disposition of this case that there were losses in excess of $50,000.00. It should be noted, however, that although First Federal did not anticipate that it would be able to meet its dividend as of June 30, 1964, the record indicates only *potential*

losses and not *actual* losses during the life of the agreement in question. (App. 68). The fact that mortgage loans are *delinquent* does not establish the *fact* of losses before August 1, 1964 when the agreement terminated.

The depositors in this case did not benefit financially from First Federal, but on the contrary, suffered losses as the result of their attempts to establish a Savings & Loan in their community. (App. 69).

The Directors of First Federal under date of May 4, 1964, sent a letter to the Federal Home Loan Bank of Chicago in which they stated that First Federal would be deficient $47,000.00 of the amount necessary to pay a current dividend on savings accounts. (App. 68). They sought the Board's permission to use escrow funds to meet current dividend requirements. They also asked the Board to require the Insurance Corporation to make a sufficient contribution to absorb all potential losses in the Sleepy Hollow Subdivision. (App. 68).

Although First Federal anticipated difficulty in meeting its June 30, 1964 dividend it submitted a merger proposal to the Federal Home Loan Bank Board which would have solved its problems and avoided the necessity of a forfeiture of the $50,000. (App. 32, 71, 68, 73). Offers of capital and absorption of potential losses including meeting of the June 30, 1964 dividend were made by various groups shortly before the merger of First Federal and Second Federal. (App. 68).

On June 8, 1964, at the request of the Board, the Directors of First Federal signed a written consent to the future appointment of a conservator or receiver for First Federal if and when the Board deemed it necessary. (App. 31). On June 15, 1964, the Board rejected various proposals submitted by the directors of First Federal.

(App. 73). On the same day the Board adopted a resolution appointing a conservator who should take charge of First Federal at the close of business on June 27, 1964. (App. 76). First Federal was not notified of this decision until June 27, 1964.

However, on June 18, 1964, the directors of First Federal held a special meeting. At that meeting, they voted to transfer $55,557.26, the balances of the pledged share accounts, to Reiter and Guntner, co-trustees, pending final determination of the status of the accounts to be held for the benefit of all the depositors. (App. 32).

The minutes of the June 18, 1964 meeting of the Board of Directors of First Federal, reflect the clear intent to make an absolute transfer of the funds in each of the deposit accounts to the depositors themselves, by means of trustees for their benefit (Pl. Ex. 26, App. 32):

> WHEREAS the directorate of this Association has submitted two separate proposals to the Federal Home Loan Bank Board for approval, either of which would have represented a practical and final solution to the Association's problems, and
>
> WHEREAS, the Federal Home Loan Bank Board has rejected each proposal, with the expressed intention to levy against certain pledged savings accounts of the Association;
>
> NOW THEREFORE, BE IT RESOLVED: That the directorate hereby directs that the funds represented by said pledged accounts in the amount of $55,557.26 be disbursed by the Association to Joseph Reiter and Leroy Guntner as co-trustees for the pledgors, to hold said funds in escrow pending final determination of the status of the accounts. (App. 32).

Pursuant to this resolution, Joseph Reiter withdrew $50,000.00 from First Federal and deposited the same in

an account in the names of himself and Guntner, co-trustees, in Merchandise National Bank of Chicago. (App. 81). On June 20, 1964, Giese, another pledgor and director, withdrew $5,557.26 and deposited it in the same names. (App. 82). Later, the funds were transferred to National Boulevard Bank of Chicago. (App. 94). The rights of the respective parties in the specific account or deposit of $50,000.00 in National Boulevard are what are in issue before this Court. The matter of the sum of $5,557.26 is not involved, the defendant having conceded that plaintiffs were entitled to it.

It is to be noted at this point that under the 1959 Agreement the Federal Home Loan Bank was given possession of the passbooks to the deposit accounts. However, First Federal itself retained actual possession of the funds until the June 18, 1964 transfer. (App. 64).

On June 22, 1964, subsequent to the transfer of funds by the Directors, the Board found that an impairment in capital of First Federal existed. Pursuant to the provisions of the Pledge and Escrow Agreement, it directed the Federal Home Loan Bank of Chicago to deliver the pledged share accounts to First Federal for cancellation and for transfer of the dollar amounts thereof to its reserves for the purpose of absorbing losses. (App. 33, 34). The conservator took charge of First Federal at the close of business on June 27, 1964. On June 27, 1964, a "Sale and Purchase Agreement" was entered into between the conservator, on behalf of First Federal, and the Insurance Corporation. (App. 41). The purpose of this Agreement was to facilitate a merger of First Federal into Second Federal Savings and Loan Association of

Chicago (Second Federal), an established institution. (App. 41). This Agreement required the Insurance Corporation to purchase an enumerated list of assets of First Federal consisting of mortgage loans (App. 42, 79) and also obligated it to purchase additional such assets of $1,000,000.00 during the following six months, which assets would be selected by the association. (App. 43). The Insurance Corporation further assumed all undisclosed facilities of First Federal. (App. 44).

The Merger Agreement between First Federal and Second Federal became effective on June 27, 1964. (App. 36, 77). The Merger Agreement provided that First Federal shall be merged with and become part of Second Federal, which shall be the resulting association. (App. 36). The existing charter of Second Federal was made the charter of the resulting association. (App. 37). The Merger Agreement set forth that the resulting association shall be deemed to be, and shall be, a continuation of the identity of Second Federal. (App. 37). By the Merger Agreement all assets of First Federal, expressly including the benefits arising under the Sale and Purchase Agreement, were vested in Second Federal and all savings share accounts of First Federal were transferred to Second Federal. (App. 38, 39). The Merger Agreement also provided that "all liabilities of First Federal * * * shall be assumed by the resulting association and may be enforced against it to the same extent as if such liabilities had been incurred or contracted by it." (App. 39). The Sale and Purchase Agreement was incorporated by reference in the Merger Agreement. (App. 39).

On July 16, 1964, the Insurance Corporation obtained from Second Federal an assignment of its claim by reason of the withdrawals of $55,557.26 and the deposits thereof with Merchandise National. (App. 47). It paid Second Federal the sum of $55,557.26 therefor. (App. 49).

The District Court granted plaintiffs' motion for summary judgment holding that under the terms of the Pledge and Escrow Agreement, plaintiffs had a right of reimbursement from First Federal in the amount of $50,000.00 after the termination date of the Agreement on August 1, 1964, provided such refund would not reduce the net reserves of First Federal below three per cent of its net assets. The District Court also held that under its construction of the Merger Agreement, Second Federal assumed that liability and became obligated to make the refund in view of Second Federal's financial position. The Court further held that the Insurance Corporation was subject to the same obligation, since it had no greater rights than Second Federal, its assignor. The District Court concluded that whatever the Insurance Corporation's right to the account or deposit of $50,000.00, it was limited by, and subject to, plaintiffs' claim of reimbursement. Thus the Court declared plaintiffs to be the owners of the account or deposit in controversy and the Insurance Corporation to be without any interest therein. (App. 90-99).

On appeal the Seventh Circuit reversed, with directions, granting defendant's motion for summary judgment from which this petition for writ of certiorari is taken by plaintiffs.

REASONS FOR GRANT OF WRIT

1. The claim of the Federal Savings and Loan Insurance Corporation is based upon an illegal agreement.

This controversy has its origin in the questionable practice of the Federal Home Loan Bank (hereafter called "the Board") requiring a guarantee against future losses before issuing a Federal Savings and Loan Charter. In 1959 the Board required execution of a document entitled "Pledge and Escrow Agreement" by certain organizers planning a savings and loan association in Morton Grove, Illinois. (App. 28, 62). In addition, other persons not connected with the organization or management of the planned association also signed. Together they did deposit the sum of $50,000 in 1959 in First Federal Savings and Loan Association of Morton Grove (hereafter First Federal) in twelve regular deposit accounts insured by the Federal Savings and Loan Insurance Corporation. (App. 65).

When First Federal experienced financial difficulties over four years later the Board on June 22, 1964 ordered the $50,000 in deposits to be forfeited under the terms of the "Pledge and Escrow Agreement" to absorb losses. The depositors of the $50,000 *already* had received the $50,000 by transfer from First Federal on June 18, 1964. The Federal Savings and Loan Insurance Corporation (hereafter called the "insurance corporation") was assigned the claim to the $50,000, denied the transfer was effective, and asserted that the Directors illegally transferred $50,000 in *general* funds of First Federal basing its claim on the obligations of the "Pledge and Escrow Agreement."

It is petitioner's position that the "agreement" required by the Board was illegal in that it was beyond

the authority granted the Board in the statutory enabling provisions and in violation of the Board's own rules.

It is not disputed that Congress has not granted the Federal Home Loan Bank Board the *specific* statutory power to require guarantees as a condition precedent in the issuance of a federal savings and loan charter. The question is whether the exercise of such power is authorized by the language of §1726(b) of the National Housing Act (12 USC §1726(b)) requiring insured institutions to provide adequate reserves or 12 USC §1464(a) giving the Board the power to make necessary regulations. The Court of Appeals held that the Board's action was authorized by the language of Sections 1726(b) and 1464(a), 12 USC. It stated in the following language:

> "Plaintiffs finally argue that their pledges were invalid as beyond the authority of the Loan Bank. Section 1726(b) of the National Housing Act (12 USC §1726(b) required insured institutions to provide adequate reserves. Consistently therewith, the regulations, which are a permissible exercise of the power conferred on the Loan Bank by Section 5(a) of the Home Owners Loan Act (12 USC §1464(a)) permit the Loan Bank to prescribe whatever 'requirements as it deems necessary or desirable' (12 CFR §543.2(d)). These provisions empowered the Loan Bank to exact the $50,000 pledged as a guaranty against losses." (Appendix, p. 17a, 396 F. 2d 411).

A review of the provisions of the statute and rule referred to by the Court of Appeals will help clarify the issues. Section 5(a) of the Home Owners Loan Act (12 USC §1464(a)) provides as follows:

> "In order to provide local mutual thrift institutions in which people may invest their funds and in order to provide for the financing of homes, the Board is authorized, under such rules and regulations as it may prescribe, to provide for the organization, in-

> corporation, examination, operation, and regulation of associations to be known as 'Federal Savings and Loan Associations,' and to issue charters therefor, giving primary consideration to the best practices of local mutual thrift and home-financing institutions in the United States.'

It is clear that the above general enabling statute does not specifically authorize the Board to exact any type of guarantee as a condition for issuance of a federal savings and loan charter. It merely authorizes the Board "to provide for the organization, incorporation, etc." of federal savings and loans "under such rules and regulations as it may prescribe."

Pursuant to this authority, the Board enacted the following rule:

> "If the Board approves the application it will establish, as conditions to be met prior to the issuance of a charter, requirements as to (1) minimum number of subscribers to the association's capital; (2) minimum amount of capital to be paid into the association's savings accounts upon issuance of a charter to it; (3) guarantee by the organizers or others of the association's organization and operating expenses; and (4) such other requirements as it deems necessary or desirable. (12 CFR §543.2(d))[2]

The Court of Appeals rested the Board's authority on the catch-all language of subsection (4) "requirements as it deems necessary". Yet the Court ignored the thrust of subsection (3) which specifically limited *any* guarantees to "*organization* and *operating* expenses." In effect, the court gave subsection (4) a sufficiently broad interpretation to render subsection (3) unnecessary.

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[2] This rule has since been amended with the guarantee provision omitted as of May 26, 1965. 12 CFR §543.2(g).

With these considerations in clear focus, the conclusion is inescapable that the Board acted in contravention of its own rules. The only reasonable reading of the applicable rule is to limit the Board in the area of guarantees in spite of the "requirements as it deems necessary or desirable" clause. By any principle of interpretation, can it reasonably be argued that the Board did not intend to limit the practice of requiring guarantees to cover organization and operating expenses? The reason for limitation is obvious. Any wider authority would allow the Board to require a guarantee of any and all losses which might result in any federally chartered association. This would effectively limit control of federal savings and loans only to those wealthy enough to risk such an agreement. Such is not the intent or purpose of the Home Owners Loan Act (12 USC §1464(a)). In addition, the Board could arbitrarily require the organizers to become insurers of the deposit accounts even though Congress has exclusively placed this responsibility with the Federal Savings and Loan Insurance Corporation.

Therefore, the rule will not justify the broad guarantee practice engaged in by the Board in this case. The agreement the Board extracted from the organizers included *any and all future losses* and covered a five-year period. Subsection (3) of the Rule prohibits an interpretation authorizing the extensive guarantee which the Board required in this case. The specific limitations of lawful guarantees to organization and operating expenses renders completely untenable the Court of Appeals holding that the practice can be justified by the "necessary or desirable" language of subsection (4) of the Rule.

Since the Board exceeded its authority the guarantee agreement in this case was invalid *ab initio*. Since it was invalid and illegal, the claim of Respondent Federal

Savings and Loan Insurance Corporation, based on the invalid guarantee agreement is without merit. The Court of Appeals erred in reversing the trial court judgment for petitioners and should have held the "Pledge and Escrow Agreement" invalid. The Court of Appeals should be reversed and the judgment of the trial court affirmed.

2. The Statutory Duty of the Federal Savings and Loan Insurance Corporation to reimburse any loss of deposits in this case offsets any claim it may have to the $50,000 in controversy.

This alternative argument is best summed up as follows: The organizers and others deposited $50,000 in First Federal in 1964 pursuant to the "Pledge and Escrow Agreement." The $50,000 was deposited in twelve regular deposit accounts. The deposits were federally insured which insurance was never waived by the depositors. If losses occurred in these accounts, the Federal Savings and Loan Insurance Corporation is liable to each of the depositors. Therefore, any claim it may assert as assignee would be offset by its liability as the insurer of the accounts. Petitioners are entitled to the $50,000.

Some elaboration on this argument will be helpful. The National Housing Act requires Respondent to insure savings share accounts of depositors in a Federal Savings and Loan Association 12 USC §1726(a).

Respondent Insurance Corporation, is, without exception, required to make prompt payment of each insured account in the event of default. The statute provides:

> In the event of a default by any insured institution, payment of each insured account in such insured institution which is surrendered and transferred to the Corporation shall be made by the

> Corporation as soon as possible either (1) by cash or (2) by making available to each insured member a transferred account in a new insured institution in the same community or in another insured institution in an amount equal to the insured account of such insured member: *Provided,* That the Corporation, in its discretion, may require proof of claims to be filed before paying the insured accounts, and that in any case where the Corporation is not satisfied as to the validity of a claim for an insured account, it may require the final determination of a court of competent jurisdiction before paying such claim. 12 USC 1728(b).

Pursuant to statutory duty, *each* account in First Federal was insured by respondent. A search of the record will demonstrate that Petitioners at no time expressed any waiver of these benefits. Indeed, the "Pledge and Escrow Agreement" itself does not contain any language from which a waiver could be even *implied.* (App. 28, 62). Lacking an express waiver, and lacking language from which a waiver of the statutory benefits may be implied, there is only one conclusion that may logically be drawn: the deposits are entitled to insurance.

An additional reason to reject respondent's claim rests on the well-established principle that a statutory right will not be considered waived unless the waiver is clear and unequivocal. No authority exists to find waiver by implication.

A consideration of this argument vividly illustrates the nature of the bizarre agreement which the Board attempted. It was legally an impossibility, *ab initio.* The impossibility rests in the Board's attempt to use $50,000 in deposits that were insured as insurance against future losses. In event of default, the deposits would be lost, giving rise to a claim for insurance from the Insurance Corporation.

The Board's decision to require a guarantee by federally insured deposits indicated poor judgment on its part. If the guarantee had been by funds in a non-insured separate account or institution (a true pledge escrow or guarantee) the question would be different. If the Court of Appeals' decision is allowed to stand, an exception will have been created in the insurance provisions of the National Housing Act only because the Insurance Corporation found itself in the embarrassing position of having a worthless claim based upon an inherently illegal agreement.

The simple conclusion of the Court of Appeals that a pledgor cannot recover insurance on an insured item forfeited under the provisions of a consensual pledge (Appendix, p. 17a, 396 F2d 412) is without any support in authority or reason. A bizarre agreement such as is involved here should not be allowed to create a mischievous exception in a clear statute. The decision of the Court of Appeals must be reversed.

CONCLUSION

For the foregoing reasons, petitioners respectfully pray that a writ of certiorari be issued to the United States Court of Appeals for the Seventh Circuit.

Petitioners further pray that the judgment and opinion of the Seventh Circuit be reversed and that the judgment of the trial court be affirmed.

Respectfully submitted,

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